JOINT COMMITTEE ON TAX POLICY
January 12, 2004

To date, the Committee has held hearings related to the subject matters of: the state budget outlook, sales and use taxes, corporate and individual income taxes, property tax, including business personal property valuation, and tax expenditures, including exclusions, exemptions, and credits. The Committee began an in depth study of tax credits to determine whether this form of tax expenditure and the specific programs associated with the policy of tax credits are a cost effective and fiscally responsible use of state tax dollars that provides a useful public benefit to all citizens of Missouri.

During the Committee's deliberations testimony was received from various sources relating to the effectiveness of certain tax credit programs, particularly the Historic Preservation Tax Credit Program, the Neighborhood Assistance Program, the Rebuilding Communities Tax Credit Program, the Brownfield Redevelopment Program, the Neighborhood Preservation Tax Credit Program, and the Community College New Jobs Program. All witnesses testifying about individual programs related their experiences to the Committee showing tangible positive improvements that likely would have not been completed without the program. All witnesses also urged the Committee to recommend the continuation of the programs.

The Committee also heard testimony from the State Attorney General's Office about an ongoing investigation into possible fraudulent activities occurring within the Rebuilding Communities Tax Credit Program. The State Auditor testified that numerous audits of tax credit programs have exposed accountability and management deficiencies, as well as, data gathering and analysis problems. The Department of Economic Development testified that a lack of resources from recent budgetary cuts resulted in staff reductions and diminished the Department's ability to oversee compliance of the programs they administer. The Department also requested statutory authority to receive certain information from applicants to improve compliance, data gathering, and analytical performance.

The Committee also received testimony from an individual citizen who claimed to have been manipulated into falsely applying for benefits through the Rebuilding Communities Tax Credit Program by another individual in an attempt to defraud the state of tax credits. In his testimony the individual exposed a process that took advantage of the lack of proper safeguards and checks and balances in the Rebuilding Communities Tax Credit Program. Once the witness realized that the actions could be improper, he immediately notified the Department of Economic Development. After several unsuccessful attempts to correspond with the Department, the witness notified the press. He also told the Committee that the alleged fraudulent activity could be widespread.

The Director of the Department of Economic Development, at the request of the Committee, came before the Committee for the purpose of setting forth the time line of events related to the alleged fraudulent activity and to answer questions related to tax credit compliance. The Director stated that the Department had followed a timely investigation into the allegations and that he had since implemented a department-wide review of the tax credit compliance process.

From the information received from testimony and from further deliberations of the Committee and the realization of the need for immediate attention and action to provide tax credit accountability and review, your Joint Committee on Tax Policy submits the following recommendations:

RECOMMENDATIONS

Committee Recommendation 1. The tax credits existing in current law are frequently lacking in minimum accountability measures to assure that taxpayer money is spent for beneficial public purposes. Accountability measures should be implemented to assure compliance with existing statutes.

Many credits have commonalities that can be generalized. A system of classifications should be established and minimum requirements for each classification should be codified. The requirements will be sufficient to verify compliance and instill confidence in the tax credit system, but should avoid undue burdens on the individuals and businesses who apply for the credits.

In addition, as some administrative agencies have already established classifications and application requirements, the proposed legislation must be mindful of the existing framework to avoid additional bureaucracy. Further, because the commonalities among tax credits are limited and other economic or legal activities may influence the system, the administering state agencies should be enabled to adapt to these changes by the implementation of rules. Any such rules should be subject to the standard rules promulgation and approval requirements.

Committee Recommendation 2. The state has been unable to accomplish any fundamental cost-benefit analysis, despite its auditing power, due to the lack of data reflecting the activity that occurs subsequent to the issuance of a tax credit. Proposed legislation should implement reporting requirements focused on gathering meaningful information in order to assist future legislatures in assessing the value of tax credit programs. These reporting requirements must be varied to reflect the diverse landscape of the currently enacted tax credits.

Similar to the first recommendation, these reporting requirements should avoid undue burdens on taxpayers and should be tailored to obtaining meaningful information that leads to informed analysis. The requirements should reflect the differences between economic development credits and social benefit credits that have benefits that are not revealed in the same empirical fashion. Reporting should occur over a period of time, depending on the nature of the credit. Annual reporting should be fixed to a date certain for all credits to assist in taxpayer awareness of the reporting.

Further reporting should be the duty of the recipient of the credit, and not any subsequent purchaser, in the case of a transferred credit. An exception to this rule should be made in the case of contribution based credits. These credits are obtained differently from other credits. Contribution based credits are given to the a contributor who donates money to a specific program. The state policy is the promotion of the program, and thus reporting should be the duty of the recipient of the contribution and not the recipient of the credit. Additionally, a taxpayer receiving a credit should be made aware of the future reporting requirements prior to issuance.

Committee Recommendation 3. In order to assure that the valuable information required by recommendation 2 will be reported, a compliance system should be implemented. Failure to meet the annual reporting requirements should result in penalties. However, as the intent of the penalties is to promote compliance with reporting, such penalties should be graduated. Further, a grace period and sufficient notice requirements must be an integral part of the compliance system. A minimum of a six month grace period and at least one notice by certified mail to the last known address of the taxpayer should be included.

Penalties must also accompany fraud in the application process. If fraud is found by a court of competent jurisdiction, penalties should be fixed at one hundred percent of the value of the credit.

For ease of collection, penalties should be assessed against a noncompliant taxpayer as of the end of the taxpayer's taxable year and due and owing as of the last date of filing of the taxpayer's return. Further collection procedures should mirror or follow the existing collection procedures for income taxes.

Committee Recommendation 4. Prior to approval of any tax credit application, an administering agency shall verify through the department of revenue that the tax credit applicant does not owe any delinquent taxes, including penalties and interest. Such delinquency would not

affect the approval of the application for such tax credits, except that the amount of credits issued would be reduced by the applicant's tax delinquency.

Committee Recommendation 5. In order to assist the budgetary process in a time of fiscal crisis, legislation should require reasonable notice to the state whenever a significant number of tax credits are going to be redeemed. To facilitate this, the state should require a period of notice prior to the assessment of tax liability (the date when income tax liability is actually fixed, due and owing) whenever a large sum of credits are going to be claimed against a taxpayer's income tax liability.

Committee Recommendation 6. In an effort to establish openness and ensure public confidence in the tax credit programs, the minimum application requirements specified in recommendation 1 should be made open records once the credits have been issued. In the case where state approval of a credit application comes prior to actual issuance, the application data should also become open records at the time such application is approved. However, certain credit applications that involve personal information, such as a family's decision to adopt a child, should be excluded from this open record policy.

Committee Recommendation 7. The existing audit statutes for state sponsored cost benefit analysis should be expanded to require the same periodic examination of all credits. Current law only subjects credits administered by the department of economic development to be analyzed. Legislation should expand this in order to assess the merits of all state tax credit programs. These audits should be provided to the governor, the legislature and, specifically, the Joint Committee on Tax Policy.

Committee Recommendation 8. Once a system of gathering data for analysis, and actual studies of cost versus public benefit has been implemented, all credits should be reexamined for merit and continuation. Furthermore, the committee recommends that the committee's statutory duties be expanded to include an automatic review by the committee after each of the auditor's tax credit program audits. After this period of review, the committee will make an official recommendation to the general assembly as to the merit and suggested future treatment of each credit.